

## SUBCOMMITTEE NO. 5

## Agenda

Senator Denise Moreno Ducheny, Chair  
Senator Robert D. Dutton  
Senator Alex Padilla



### Agenda – Part B

### Hearing Outcomes

### Issues Related to Cash

Thursday, May 6, 2010  
9:30 a.m. or upon adjournment of session  
Room 113

Consultant: Brian Annis

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## 9620      Cash Management and Budgetary Loans

**Item Overview:** This budget item appropriates funds to pay interest costs on General Fund borrowing used to overcome cash flow imbalances during the fiscal year. Because receipts and disbursements occur unevenly throughout the fiscal year, the General Fund borrows in most years, even though each budget is balanced when enacted and funds are repaid within the fiscal year. Interest is paid on both internal borrowing (such as cashflow loans from special funds) and for external borrowing (such as Revenue Anticipation Notes (RANs)). This item additionally pays interest costs for budgetary borrowing by the General Fund from special funds. Budgetary borrowing is across fiscal years and is “counted” as a budget solution, whereas cashflow borrowing is not counted as a budget solution (only a cash solution).

**Budget Overview:** The January Governor’s Budget includes \$540 million for interest costs on cashflow borrowing and \$58 million for interest costs on budgetary borrowing – all General Fund. Of the cashflow amount, \$150 million is for internal borrowing and \$390 million is for external borrowing. Overall, expenditures in this item are up significantly – a total of \$598 million is proposed for 2010-11, versus revised expenditures of \$353 million in 2009-10.

(see issues on next page)

**Issues for Discussion and/or Vote**

- 1. Cash Deferrals - Action in the 8<sup>th</sup> Extraordinary Session:** In the 8<sup>th</sup> Extraordinary session called by the Governor on January 8, 2010, to address the fiscal emergency, the Legislature enacted AB X8 5 (Committee on Budget) to implement a flexible payment deferral plan for the remainder of 2009-10 and for 2010-11. AB X8 14, enacted two weeks after AB X8 5, made further improvements to the cash management plan. The legislation provides approximately \$5 billion in cash flow relief that will reduce the size and cost of the State's short term borrowing. By enacting a 2010-11 deferral plan in February 2010, the legislation provides more predictability for local governments and allows more time for local fiscal planning.

**Detail on AB X8 5 and AB X8 14:** The chaptered language provides statutory authorization to defer specific cash payments to schools, universities, trial courts, and local governments. The language specifies maximum deferral amounts and the maximum length of the deferral. Language is also included to "smooth" cash payments to the University of California and California State University so that they are relatively the same each month of the fiscal year. All of the deferrals are limited to the current and budget year only and specified deferrals may be triggered off by findings of the State Controller, the Director of Finance, and the State Treasurer. The language also changes the dates of the bi-annual contributions to the State Teachers' Retirement System. Attachment A to this agenda provides monthly detail on the cash management plan; however, the deferral plan is flexible and specified deferrals may not take place if the state's cash is sufficient.

**Some Spring 2010 Deferrals Triggered-off:** Due to favorable cash receipts in December through March, the State Controller, the Director of Finance, and the State Treasurer, were able to certify sufficient General Fund cash resources and turn off certain March/April 2010 cash deferrals. Specifically, in a March 18, 2010, letter, the deferrals for Trial Court operations and the California Community Colleges were "triggered-off" and the payments were made as scheduled. In an April 1, 2010, letter, the deferrals for the California State University and the University of California were "triggered-off" and the payments were made as scheduled.

**Staff Comment:** This is an informational issue – the LAO and the Department of Finance can present the information on the attachment and answer any questions. New trailer bill language associated with the special-session action is discussed in the "trailer bill language" issue later in this agenda.

**Action:** *Informational issue – no action taken.*

- 2. Budget Funding for Interest on General Fund Loans:** As indicated in the introduction to this issue, the Governor requests \$598 million General Fund to pay interest in 2010-11. This amount is over \$300 million higher than revised estimates of costs for the current year. The table below indicates the interest costs per category across the three fiscal years (in millions):

Type of loan	2008-09 Actual Cost	2009-10 Revised Estimated Cost	2010-11 Estimated Cost
External Cashflow Borrowing	\$152.3	\$121.3	\$390.0
Internal Cashflow Borrowing	\$124.9	\$150.0	\$150.0
Budgetary Loans	\$0	\$13.0	\$58.0
Contingency	\$0	\$69.0	\$0
<b>TOTAL</b>	<b>\$277.2</b>	<b>\$353.0</b>	<b>\$598.0</b>

The 2009-10 funding in the table reflects mid-year adjustments. The amount originally budgeted for 2009-10 was \$546.6 million. That amount was reduced to the current estimate after the cost of external borrowing came in significantly below estimates.

**Budget Flexibility to Augment Funding:** Funds to pay interest for external cashflow borrowing are continuously appropriated, and therefore expenditures may exceed the amount budgeted as necessary. Funds to pay interest for internal cashflow borrowing and to pay interest for budgetary borrowing, are appropriated in the budget act; however, budget bill language allows the Department of Finance to augment the appropriation if needed to pay interest costs. Due to this budgetary flexibility, the Legislature need not build in contingency funding for this item, but rather, can fund at the level of anticipated expenditures.

**Deleted Budget Bill Language for Joint Legislative Budget Committee (JLBC) Reporting:** The 2009 Budget Act included the following budget bill language (BBL) for Item 9620-002-0001 related to budgetary loans; however, this language is deleted from the proposed 2010 Budget Act:

*Provision 2: The Director of Finance shall notify, in writing, the Chairperson of the Joint Legislative Budget Committee within 30 days of ordering the repayment of any loan included within the provisions of this item.*

**Changes to Budgetary Borrowing:** As indicated above, the budget assumes \$58 million to pay interest on budgetary borrowing. Small adjustments may be necessary to conform to other budget actions. For example, the January budget assumed General Fund repayment to the Beverage Container Recycle Fund of \$153 million over 2009-10 and 2010-11. Action in the 8<sup>th</sup> Extraordinary Session (AB X8 7) modified the Governor's proposal and should reduce the amount of the loan repayment by about \$46 million. The conforming action here would be a reduction in the associated interest of around \$5 million in 2010-11.

**Staff Comment:** Since the last couple of years have also been very difficult budget years requiring high levels of cashflow borrowing, and interest rates continue to be low, the Administration should indicate why the estimated interest cost is over \$300 million higher in 2010-11. The Administration should also indicate why they propose to delete the JLBC reporting language. Small adjustments may be necessary to conform to other budget actions in the area of budgetary borrowing. Finally, the amount of 2009-10 contingency funding should be reduced to reflect additional General Fund savings.

**Staff Recommendation:** Restore the JLBC reporting language. Request that with the May Revision, the Administration shares assumptions behind the updated 2010-11 interest estimate with Committee Staff.

**Action:** *Approved restoration of JLBC budget bill language on a 3 - 0 vote.*

## 9625 Interest Payments to the Federal Government

**Item Overview:** This budget item provides expenditure authority for the payment of interest to the federal government for federal funds held in State accounts. Under federal law, interest is sometimes required for the period between when federal funds are deposited in a state account and the disbursement of the funds for the program purpose.

**Budget Overview:** The Budget includes \$30 million General Fund and about \$1 million in special funds for interest payments. This is the same level of funding approved with the 2009 Budget Act; however, the Department of Finance has since reduced the estimate of 2009-10 General Fund interest costs from \$30 million down to \$5 million. The table below, with data from the Governor's Budget, shows the three-year costs (in millions):

Type of loan	2008-09 Actual Cost	2009-10 Revised Estimated Cost	2010-11 Estimated Cost
General Fund cost	\$13.9	\$5.0	\$30.0
Other funds cost	\$0.3	\$1.0	\$1.0
<b>TOTAL</b>	<b>\$14.2</b>	<b>\$6.0</b>	<b>\$31.0</b>

### Issues for Discussion and/or Vote

- 1. Funding Level and Budget Control Language:** As indicated above, the Administration requests \$30 million General Fund, and about \$1 million in special funds, for interest payments to the federal government. In past budgets, provisional language in the budget bill has allowed the General Fund amount to be augmented by up to \$10 million, and for the special fund amount to be augmented by up to \$1 million – both after 30-day Joint Legislative Budget Committee (JLBC) reporting. The language proposed this year would remove any caps on augmentations, but would retain 30-day JLBC reporting.

**Staff Comment:** Since interest rates continue to be low, the Administration should indicate why the estimated interest cost is \$25 million higher in 2010-11. The Administration should also indicate why they propose to remove the statutory caps on funding augmentations. Due to the budgetary flexibility to augment funding, the Legislature need not build in contingency funding for this item, but rather, can fund at the level of anticipated expenditures.

**Staff Recommendation:** Hold open for the May Revision, when updated estimates from the Administration may be available. Request that the Administration share assumptions behind the updated 2010-11 funding estimate with Committee Staff.

**Action:** *Held open for May Revision.*

## 9600 Debt Service General Obligation Bonds and Commercial Paper

**Item Overview:** Debt service payments are continuously appropriated, and therefore not appropriated in the annual budget bill. This item in the Governor's Budget Galley displays the estimated debt service costs for each General Obligation bond (GO bond). Some bond costs are offset by special funds or federal funds – primarily by the transportation debt service fund. Other bonds are “self liquidating,” or have their own dedicated revenue (i.e., the Economic Recovery Bonds receive a quarter-cent of the sales tax) – the self-liquidating bonds are not included in this item.

**Budget Overview:** The January Governor's Budget includes \$5.0 billion in General Fund costs for GO debt service and related costs. In addition to this amount, \$951 million in debt costs are funded from other funds (i.e., \$929 million is from the transportation debt fund that is associated with the fuel swap in the special session). Finally, federal bond subsidies, through the Build America Bonds (BABs) program, provide \$224 million in 2010-11. The table below, with data from the Governor's Budget, shows the three-year GO bond costs (in millions, excluding self-liquidating bonds):

	<b>2008-09 Actual Cost</b>	<b>2009-10 Revised Estimated Cost</b>	<b>2010-11 Estimated Cost</b>
General Fund cost	\$3,791	\$4,834	\$5,010
Other funds cost	\$282	\$200	\$951
Federal subsidy (Build America Bond Program)	\$0	\$158	\$224
<b>TOTAL</b>	<b>\$4,073</b>	<b>\$5,192</b>	<b>\$6,185</b>

The table above excludes a Legislative change made in the 8<sup>th</sup> Extraordinary Session – the fuel swap (AB 8X 9, Committee on Budget) increased the 2009-10 funding from the transportation debt service fund by \$162 million above the Governor's proposal, which results in General Fund savings of that same amount.

(see issues on next page)

**Issues for Discussion and/or Vote**

- 1. Overview of GO Bonds and Bond Debt:** As indicated in the introduction to this issue, the January budget includes \$5.0 billion General Fund to pay GO bond debt in 2010-11. Attachment B of this agenda summarizes all the voter-approved GO bonds that currently have debt service. The table also provides a summary of overall budget authority and the status of sale and repayment for all bonds.

**Federal Stimulus Program - Build America Bonds (BABs):** BABs are taxable municipal bonds that carry special tax credits and federal subsidies for either the bond issuer or the bondholder. BABs were created as part of the American Recovery and Reinvestment Act (ARRA) that President Barack Obama signed into law on February 17, 2009. Since the federal BABs program was implemented, Treasurer Lockyer has sold about \$10.7 billion in GO bonds using the BABs program. For these BABs, the federal government will pay California a cash subsidy equal to 35 percent of the interest costs – which over the life of the bonds will total to about \$7.9 billion.

**Staff Comment:** Representatives from the State Treasurer's Office, the Department of Finance, and the LAO are available to discuss the BABs subsidies and other budget issues associated with GO bonds.

**Staff Recommendation:** This is an informational issue.

**Action:** *Informational issue – no action taken.*

- 2. Administration's Cash Management Plan for GO Bond Revenues:** On April 27, 2010, the Department of Finance released Budget Letter 10-09, which lays out a new Administration plan for the management of GO bond proceeds. The Budget Letter indicates that as a result of the recent successful GO bond sales and other factors, departments are now able to plan on having bond proceeds at specific times of the year. The plan anticipates \$6.4 billion in proceeds from fall 2010 bond sales and \$6.7 billion in proceeds from spring 2011 bond sales. Departments are provided their individual level of cash proceeds in each six-month period, and are able to move forward with new projects with the funding specified in the plan. The plan will be updated semi-annually. Attachment C of this agenda is the Administration's bond cashflow plan.

**Staff Comment:** Representatives from the State Treasurer's Office, the Department of Finance, and the LAO are available to discuss the Cash Management Plan for GO Bonds.

**Staff Recommendation:** This is an informational issue.

**Action:** *Informational issue – no action taken.*



## Cash-Related Trailer Bills

**Summary of proposals:** The Administration has proposed various pieces of trailer bill language related to cash. The first issue below is suggested clean-up to action already taken in the 8<sup>th</sup> Extraordinary Session. The remaining issues are Administration proposals from the January Budget and from April Finance Letters.

### Issues Suggested for Vote Only:

- 1. Clean-up to Special Session Cash Measures:** Additional amendments have been suggested by the Administration and other parties to clean-up or clarify the cash-related measures adopted in the 8<sup>th</sup> Extraordinary Session (AB X8 5 and AB X8 14). Specifically, the proposed language would: (1) clarify the process for school districts to apply for a hardship waiver to be excluded from any deferrals in 2010-11, and (2) create a hardship waiver process for the deferral of Highway User Tax Account (HUTA) apportionments to exempt a city that has bonded against the HUTA apportionment, as specified.

**Staff Comment:** Staff is not aware of any concerns with this language.

**Staff Recommendation:** Approve as placeholder language.

**Action:** *Approved placeholder trailer bill on a 3 – 0 vote.*

- 2. Tax Credit Allocation Fee Account Reclassification:** In a January proposal, the Administration requests language to reclass the Tax Credit Allocation Fee Account, such that any General Fund cashflow borrowing will require an interest payment. The Department of Finance indicates that is a technical fix and this type of special fund should receive interest under state law. Since the fund balance is relatively small (about \$4.2 million) any additional General Fund interest costs would be minor.

**Staff Comment:** Staff is not aware of any concerns with this language.

**Staff Recommendation:** Approve as placeholder language.

**Action:** *Approved placeholder trailer bill on a 3 – 0 vote.*

- 3. State Treasurer's Office – Local Agency Investment Fund fees:** In an April request, the Administration proposes language to adjust the limitations on administrative cost recovery for the Local Agency Investment Fund (LAIF). The LAIF is a voluntary program created in 1977 as an investment alternative for California's local governments and special districts. The LAIF program offers local agencies the opportunity to invest idle funds and earn a competitive yield using the investment expertise of the Treasurer's investment staff at no additional cost to the taxpayer. LAIF has nearly 3,000 participants and nearly \$25 billion in investments.

Existing law allows the Treasurer's Office to deduct up to one half of one percent of the LAIF earnings to cover reasonable costs it has incurred in carrying out the provisions of the program. This has historically left enough of a buffer for the Treasurer's office to fully cover the annual costs of administering the program, approximately \$1.8 million. Recently, however, because of market conditions and lower balances, the fee revenue at the cap is only producing about \$200,000.

**Staff Comment:** This proposal would raise the cap 0.5 percent to 5.0 percent. Reimbursement of administrative costs is already limited in current law to "the reasonable costs incurred in carrying out the provisions" to operate LAIF. LAIF has added only one staff position in the past ten years, despite doubling their investment amounts.

**Staff Recommendation:** Approve as placeholder language.

**Action:** *Approved placeholder trailer bill on a 2 – 1 vote, with Senator Dutton voting no.*

- 4. State Treasurer's Office – Past Due Bond Redemption:** In an April request, the Administration proposes language to allow the State Treasurer to redeem matured bonds and coupons that are ten years or more past their call date when presented for payment by the bondholder. Currently, for matured bond and coupons retrieved ten-years past their call date, claims must be paid through the Victims Compensation and Government Claims Board (VCGCB). The Board is authorized to assess a 15 percent surcharge on those matured bonds and coupons that are redeemed through their existing process. The Board has recently begun charging that fee to the Treasurer's Office. This language would allow the Treasurer to avoid that fee and move the bond work in-house. The Treasurer suggests this proposal will result in General Fund cost avoidance of up to \$665,000 by the Treasurer absorbing the bond reimbursement workload instead of reimbursing the VCGCB.

**Staff Comment:** No concerns have been raised with this proposal.

**Staff Recommendation:** Approve as placeholder language.

**Action:** *Approved placeholder trailer bill on a 3 – 0 vote.*

**Issues Discussion and Vote:**

- 5. Federal Funds for Statewide Indirect Costs:** In a January request, the Administration proposes language to allow the Director of Finance to reduce a department's budget and transfer associated funds to the Central Service Cost Recovery Fund, the General Fund, or both, in the case where a department has not collected indirect cost funding from the federal government. For a federally-funded program, the federal government allows the state to direct a portion of the federal funds to cover the proportional centralized administrative costs of the state. The transfer authorized by this action would occur, if in the judgment of the Director of Finance, a department has not collected indirect cost funds from the federal government, regardless of the reason.

**Staff Comment:** It is unclear if uncollected federal indirect cost funds are a problem for California – the Department of Finance should speak to the problem they are trying to solve with this language. To the degree federal funds are under-collected, this proposal could result in relief to the General Fund as department budgets would be cut with related state funds shifted to the Central Service Cost Recovery Fund or the General Fund. Since the amount that “should have” been collected from the federal government is subjective and relies on the Director of Finance, amendments may be warranted to limit the amount of any budget reduction and to add a sunset and reporting requirement.

**Staff Recommendation:** Hold open for further analysis.

**Action:** *Held open.*

- 6. Prompt Payment Act:** In a January request, the Administration proposes language to revise the Prompt Payment Act, which defines deadlines for the State to timely pay invoices and pay refunds. Current law requires payment of an undisputed invoice within 45 days and undisputed refunds within 31 days. This language would standardize the timeline, and make both deadlines 45 days. Current law requires late payment penalties for certain small and nonprofit businesses to accrue at 0.25 percent of the amount due, per calendar day. This equates to an over 90 percent annual interest rate for these small businesses and nonprofit organizations. The proposed language would change the penalty to accrue at 10 percent above the United States Prime Rate on June 30 of the prior business year.

**Staff Comment:** This language would reduce the State's costs in the case of undisputed refunds that are paid more than 31 but less than 45 days after receipt of the notice. This bill would also reduce the state's penalty costs for late payment of bills to certain small and nonprofit businesses.

**LAO Recommendation:** The LAO recommends that the Legislature approve the proposed trailer bill. The legislation would consolidate code provisions, thereby reducing potential administrative confusion about the state's late payment penalties. Penalties owed to certain small businesses and nonprofit organizations for late payments would remain substantial and still deter late payments by state departments, but these payments would be reduced to a much more reasonable level.

**Staff Recommendation:** Approve as placeholder language.

**Action:** *Approved placeholder trailer bill on a 2 – 1 vote, with Senator Dutton voting no.*